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SUBJECT: MALDIVES ECONOMY GREW BY 6.6% IN 2007

11. (SBU) Summary: In 2007, Maldives economy grew by 6.6%, marking a return to its pre-tsunami growth path. Tourism drove the growth, with visitors up 12% to over 675,000. Tourism-related activities, such as transport and communications, and construction of new resorts, also contributed to growth. Fisheries declined due to a drastic drop in the fish catch. The government is continuing heavy deficit spending both for tsunami reconstruction and infrastructure development. Despite a growing trade deficit, the balance of payments remains in surplus on strong tourism receipts, advance resort rentals, and continued tsunami-related aid flows. With much of the deficit spending being on productive infrastructure development, and tourism industry prospects remaining strong, Maldives' economic fundamentals appear solid. At the same time, President Gayoom may benefit politically from the increased spending as he faces his first competitive re-election campaign later this year. End Summary.

GDP UP BY 6.6% TO \$3,400 PER CAPITA

12. (U) According to the Maldives Monetary Authority, Maldives' economy grew by 6.6% in 2007 -- comparable to its average annual growth rate of 7.4% in the decade before the December 2004 tsunami. Growth was slower than in 2006 when gross domestic product rose by 19% on tsunami recovery and reconstruction. Total GDP exceeded \$1 billion in 2007, or about \$3,400 per capita (based on a population of about 300,000 as estimated by the Ministry of Planning). This level gives Maldives the highest per-capita GDP in South Asia.

TOURISM AGAIN STRONG; FISHERIES DECLINE

13. (U) Tourism, the most important economic sector, accounting for 28% of GDP, had another good year. Arrivals rose by 12% to over 675,000. Revenue from tourism is estimated at \$494 million. Europe generates almost 75% of visitors. China and Japan, together, account for another 10%. The tourism boom has boosted other sectors of the economy as well. Transport and communications, which account for 20% of GDP, grew by 15%. Construction is also booming, with 19% growth, partly due to development of several new resorts. Government administration, which accounts for 16% of GDP, expanded by 4.4%. The main export sector, fisheries, which accounts for 4.5% of GDP, declined considerably. The fish catch decreased by 39% during the eleven months to November 2007. Fish prices remained high, but the low catch dragged fish export earnings to about \$110 million in 2007 from \$133 million in 2006. The government reported an improvement in the fish catch towards the end of 2007. (Note: Fisheries and Agriculture Ministry sources were unsure of the reason

for the decline but did not think it was permanent or due to over-fishing. A representative of a private fisheries company told EconFSN that the fish catch declines temporarily every three to four years.)

BUDGET DEFICITS GROWING, INFLATION RISING

14. (U) The World Bank, the Asian Development Bank, and the International Monetary Fund have all cautioned Maldives against unsustainable spending since 2005. The government's budget deficit increased to 25% of GDP in 2006. In 2007, the Government planned to spend Rf 11.8 billion (\$920 million or 88% of GDP) in 2007. Revenue was to rise to Rf 7.1 billion (\$555 million or 53% of GDP). These figures would yield a deficit of nearly 35% of GDP.

15. (U) Over 75% of revenue was expected from import duties and resort lease rentals. Other major revenue sources are taxes on tourism and bank profits, work permit fees, and state-owned company profits. The government also borrowed \$30 million for eight years from HSBC bank at commercial rates in September 2007 (only the second time it has borrowed in international commercial markets) to repair jetties and harbors damaged by the tsunami. Commenting on this to Agence France-Presse, Finance Minister Gasim Ibrahim said, "We got about \$400 million in international aid [following the tsunami], but we are still short of about \$70 to 80 million to

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complete projects related to fishing and transport."

16. (U) The higher deficit and high import prices produced inflation, which surged to 6.8% in November 2007 from 3.5% in November 2006. Broad money increased by 24% as both public and private sector credit expanded sharply.

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TRADE DEFICIT UP, BUT BALANCE OF PAYMENTS STILL POSITIVE

17. (U) On the external side, the trade deficit has widened steeply in the post-tsunami years. The trade deficit more than doubled from \$383 million in 2004 to \$704 million in 2007. Imports of food and construction material rose sharply. Thanks to the \$494 million tourism earnings and advance payments from newly-leased resorts, the balance of payments recorded a surplus of \$48 million in 2007. External reserves stood at \$309 million, sufficient to cover 3.4 months of imports. Total outstanding external debt stock stood at \$524 million.

18. (U) The Maldives government projects the economy to expand by 9.5% in 2008, again on the strength of tourism and related construction. Fish exports are also expected to make a recovery. Given higher import prices and increasing imports, the current account deficit is expected to deteriorate further in 2008. A small BOP surplus of under \$10 million is expected.

COMMENT: DEFICIT SPENDING IS WORTHWHILE INVESTMENT

19. (SBU) The government of Maldives appears to be practicing the virtuous kind of deficit spending -- investing in infrastructure that has potential to yield both social and economic returns in the future. Some examples:

-- improving harbors on small residential islands facilitates fishing and ensures vessels are safe in bad weather;

-- expanding the international airport and building conference and other related facilities on the airport island both increase the country's tourism capacity and diversity;

-- building small domestic airports increases the tourism industry's ability to move visitors from the international airport in Male' to resorts farther from the capital.

-- building residential housing near overcrowded Male' relieves housing pressures there.

110. (SBU) With these efforts adding to the country's prospects for continued strong tourism revenue, it appears that the government continues to manage the economy in a fundamentally prudent manner. With Maldives earning the highest GDP per capita in South Asia, the spending is also likely to translate into improved standard of living for average Maldivians commensurate with the country's growing income. Not coincidental to this is the fact that President Gayoom is entering his first-ever genuine election cycle; he surely calculates that spreading the wealth generated by the tourism boom will increase his popularity.

BLAKE